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James P. Mayer
Executive Director
Little Hoover Commission
925 L Street, Suite 805
Sacramento CA 95814

RE: Testimony by Jane Graf, President of Mercy Housing California before the Little Hoover Commission on January 24, 2002

Dear Mr. Mayer:

It is with pleasure that I submit the following letter addressing some issues of concern related to the funding mechanisms that finance affordable housing in the State of California. This is a vast topic and my letter captures only a small number of the most pressing issues that confront the affordable housing industry as we work to meet the housing needs of low and moderate income California citizens. I look forward to the questions and dialogue on this topic at the hearing on January 24th.

1) INCREASE FUNDING FOR AFFORDABLE HOUSING

- A. Expand Funding for Multifamily Housing and Supportive Housing in All Communities
(The State should invest at least \$50 million per year towards the Supportive Housing Initiative and \$250 million per year in rental housing production stimulus; a predictable, steady source of funding helps allow for efficient administration and planning of public resources for housing)

Rental housing is the major component of the affordable housing supply in the state. The continued production of rental housing is essential to meeting the housing needs of the growing mobile workforce. Increasing the housing supply and locating affordable rental housing in areas of job growth is essential to address the traffic gridlock that occurs in many of the state's urban areas.

Supportive housing — affordable permanent housing in which social, health and employment supports are easily accessible — is the most successful

and cost-effective way to help people with special needs live as independently as possible.

B. Preserve The Existing Affordable Housing Stock

(The State should invest at least \$25 million per year in state resources in a preservation program and work in concert with experienced groups in California to preserve the existing housing stock)

One threat to the affordable living arrangements of many of the state's lowest income residents is HUD's restructuring and cutbacks in the Section 8 rental subsidy program. An estimated 20% of the state's 117,000 Section 8 housing units could be lost from the affordable housing stock due to owners opting out of the federal subsidy program. Efforts at the state level to preserve this assisted housing should be expanded and more resources for this purpose made available. These resources should be available to all of the many organizations who have been working over the years to preserve this housing.

2) SECURE A PERMANENT AND DEDICATED REVENUE SOURCE FOR AFFORDABLE HOUSING

(The State should take the lead in identifying and securing a permanent dedicated revenue source for affordable housing production)

A dedicated, predictable source of revenue is essential to meeting the varied affordable housing needs of the California citizenry. Less reliance on politically sensitive bond measures that fund sporadic housing programs that start and stop is a very important step.

Ironically, California was the first state in the nation to establish a state housing trust fund. Unfortunately, the revenue source selected never generated sufficient funding for a real housing production program. A permanent housing subsidy source could be linked to housing-related revenues. Due to concerns about raising taxes, it may be more viable to redirect existing revenues than to add new taxes. In an expanding economic environment, existing revenue sources may be generating higher amounts to accomplish this redirection. Legislation would be required to enact this approach.

The following three characteristics define a housing trust fund:

1. a program that has secured a dedicated source of on-going revenue;
2. a program that is committed to the production and preservation of housing affordable to lower income households, including the needs of the homeless;
3. a program which represents funds that would not otherwise be used to address housing needs, such as federal HOME or CDGB funds.

There are 38 housing trust funds adopted by states throughout the country. Sixteen different revenue sources have been committed to state housing trust funds. The most popular source of revenue for a state housing trust fund is the real estate transfer tax (12 states have committed these funds to their housing trust funds). Other more popular sources are: interest from real estate escrow, document recording fees, bond reserve accounts, other financing fees, and a variety of other sources.

Approaches to Creating a State Housing Trust Fund

1. Increasing or Redirecting State-Level Tax Revenue
2. Creating New State-Level Tax Revenue
3. Reinstating Taxes or Eliminating Exemptions
4. Increasing or Redirecting State-Level, Non-Tax Revenue
5. Creating New State-Level Non-Tax Revenue
6. Increasing, Redirecting, or Creating Local-Level Revenue

Description of the Most Likely Funding Sources

It is important to note that we need a revenue source for California which generates a significant (i.e., \$250 million per year or more) amount of revenue each year. The top three potential dedicated revenue sources at the state level are as follows:

1. Real Estate Transfer Tax (also called Documentary Stamp Tax):
Documentary stamp tax or transfer tax, is assessed when titles are transferred or ownership otherwise changes (with some exceptions). Currently in California, a transfer tax of \$1.10/\$1,000 is charged to the seller on the County level. In addition, many cities also charge a transfer tax. In some cases the city-level tax is split between the buyer and the seller. City-level taxes range from \$1.10/\$1,000 to \$20/\$1,000.

A portion of the documentary stamp tax or transfer tax could be diverted to the Housing Trust Fund. This is the most popular source nationally and generates substantial revenue (over \$120 million in Florida). *This source would be our most promising source if it is not prohibited under Proposition 13. Analysis of the state constitution, changes to it since the enactment of Proposition 13, as well as the impact of Proposition 98 will be required.*

2. Bank and Corporation Tax: Currently, the state collects taxes from banks and corporations and the revenue is placed in the General Fund. The bank and corporation tax is one of the three largest revenue sources in the state's general fund. A possible source of funds is to redirect a portion of the bank and corporation tax revenue to the Housing Trust Fund or to increase the tax rate with the increment going to the Fund. Redirecting only a small portion of the bank and corporation tax collections could generate a large amount of revenue. Just 5% of the taxes would yield over \$281 million annually. There is a very strong nexus with this source of funds because banks and

corporations often employ low-income workers who need affordable housing. Also, our recent success in securing a large general fund appropriation for housing could make this more politically feasible.

3. **Document Recording Fees:** The document recording fee is a tax-based source assessed at the local level. Revenue would be generated for the Trust Fund through a tax assessed on every document recorded at the County recorder's office. Currently, fees are already charged for document recordings. The Trust Fund tax would be added to the fees already charged and the revenue would be transferred to the Housing Trust Fund. (This would require a 2/3 vote and might not generate that much annual revenue - \$20 million per year).

Other possible sources include capturing the interest on escrow accounts, interest on tenant security deposits, interest on funds currently held by state housing agencies (such as CHFA), limiting the mortgage interest deduction, creating a fee or tax on insurance policies, enacting a statewide hotel tax or employer tax for low wage industries, and creating a statewide building permit tax (based on a percentage of the building's value).

And finally, another approach would be to assemble a package of a variety of different, smaller funding sources that add up to a large annual appropriation.

3) SET SHARED STATE HOUSING PRIORITIES AND REDUCE RED TAPE

(The State should foster greater coordination between its various housing finance agencies and initiate efforts to lower the cost of monitoring for both state agencies and borrowers, focusing oversight on troubled and non-compliant properties)

The State's housing efforts are dispersed among a number of agencies. Priorities and timing of state-allocated housing resources could be much more coordinated. Certain consistent principles would be helpful in all housing resources allocations, including equitable geographic benefits, giving weight to local priorities in making state allocations, and coordinated deadlines for tax credits, tax-exempt bond and state funding programs.

The monitoring of state housing programs are currently managed by each individual agency with little to no coordination and sharing of resources. This is a burden on the agency as well as the sponsor/owner who is required to provide duplicate information in varying formats and spend significant staff time with the various agency personnel. A lead agency monitoring function could alleviate the costly duplication whereby an agreed upon state agency would monitor for all state programs. Additionally, attention where attention is needed should rule the day – focus on troubled and non-compliant properties rather than treating all properties in the same manner.

4) COST REDUCTION TECHNIQUES AND STRATEGIES ARE PUNITIVE, INEFFECTIVE AND HAVE LONG TERM NEGATIVE IMPACTS

The tendency in all state programs to reduce their per unit support, disallow program proceeds to cover supportive services, reduction in fees allowed to cover developer expenses, requirement to leverage state funds at higher and higher levels, unreasonably low annual fees allowed for asset management costs (if allowed at all) and desire to spread their shrinking resources thinner and thinner is a recipe for disaster.

a) Support services should be considered as an “operating expenses” for projects. For example, the MHP program requires a support services plan (§ 7324 (d)(13)) for special needs projects but then refuses to allow services as an operating expense. The success and long term viability of this housing is directly linked to the support provided to the residents. This is a short-sighted policy. If necessary, HCD could establish a limit on service costs based on a per bedroom formula and the population served.

b) The excessive requirements to leverage funds in all state programs increases the complexity of the financing to a point that at the very least neutralizes any benefit and in fact significantly increases cost over time. All funding sources come with complicated compliance and monitoring requirements that increase asset management cost, compliance department expense, transaction cost, etc. Legal and financial consulting expenses are dramatically increased as the transaction becomes more complex. 3rd party monitoring fees of banks and investors increase as the potential for error in compliance rises. The difficulty in finding the resources to finally “close the funding gap” adds years to the development timeline and thus additional cost. HCD and TCAC have continued to emphasize the need for other funds by adding points for reducing credits (in the case of TCAC) and adding points for leveraging other funds (in the case of HCD). Additionally, the constant change in these scoring criteria is highly disruptive to developments that have been years in the predevelopment phase, are finally ready to apply for financing, only to discover they are now financially infeasible under the new scoring criteria.

c) Affordable housing is financed with one of the most complex structures that exists in financial transactions and this complexity increases every year. There is no acknowledgement of the increased cost to the owner in the short or long term. In fact, it is assumed that these costs will simply be magically absorbed. These increased costs result from the increased level of sophistication and knowledge needed to structure and close the housing transaction initially; the highly skilled staff and department needed to manage the regulatory and compliance reporting during the life of the asset; and the highly skilled and versatile property management company needed to manage the

property with the often complicated resident mix and service requirement that is mandated by state and local programs. All of these requirements are increasing in their complexity and demands in an environment that not only does not want to provide the funds to adequately support the work, but in an environment that seeks to spread the housing dollars even further.

I hope these initial comments are helpful and I look forward to the discussion at the hearing on the 24th.

Sincerely,

Jane M. Graf, President